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BEFORE THE ARIZONA CORPORATION

COMMISSIONERS

JEFF HATCH-MILLER - Chairman  
WILLIAM A. MUNDELL  
MARC SPITZER  
MIKE GLEASON  
KRISTIN K. MAYES

2006 JUN -21 P 2:44

AZ CORP COMMISSION  
DOCUMENT CONTROL

IN THE MATTER OF THE APPLICATION OF  
BLACK MOUNTAIN SEWER CORPORATION,  
AN ARIZONA CORPORATION, FOR A  
DETERMINATION OF THE FAIR VALUE OF  
ITS UTILITY PLANT AND PROPERTY AND  
FOR INCREASES IN ITS RATES AND  
CHARGES FOR UTILITY SERVICE BASED  
THEREON.

DOCKET NO. SW-02361A-05-0657

**STAFF'S NOTICE OF FILING  
TESTIMONY SUMMARIES**

Staff of the Arizona Corporation Commission hereby files the Testimony Summaries of  
Crystal Brown, Pedro M. Chaves and Marlin Scott, Jr. of the Utilities Division in the above-  
referenced matter.

RESPECTFULLY SUBMITTED this 2<sup>nd</sup> day of June, 2006.

Keith Layton, Attorney  
Legal Division  
Arizona Corporation Commission  
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Phoenix, Arizona 85007  
*Attorneys for Staff*

Original and thirteen copies filed  
this 2<sup>nd</sup> day of June, 2006 with:

Docket Control  
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Phoenix, Arizona 85007

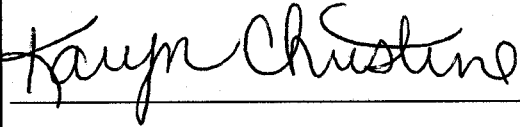
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1 Copies of the foregoing were mailed  
2 on this 2<sup>nd</sup> day of June, 2006 to:

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**SUMMARY OF TESTIMONY  
BLACK MOUNTAIN SEWER CORPORATION  
DOCKET NO. SW-02361A-05-0657  
STAFF WITNESS - CRYSTAL BROWN  
June 2, 2006**

I will appear on behalf of the Arizona Corporation Commission Staff and will testify concerning Staff's position and recommendations regarding Black Mountain Sewer Company's ("Black Mountain" or "Company") application for a permanent rate increase in the areas of rate base, operating income, and revenue requirement. My testimony is summarized below:

Staff recommends total annual operating revenue of \$1,468,433, which represents an increase of \$262,981, or 21.82 percent, over Staff adjusted Test Year revenues of \$1,205,452. The recommended revenue would produce an operating income of \$178,402 for a 9.60 percent rate of return on the original cost and fair value rate base of \$1,858,356.

**SUMMARY OF TESTIMONY**  
**BLACK MOUNTAIN SEWER CORPORATION**  
**DOCKET NO. SW-02361A-05-0657**  
**STAFF WITNESS – PEDRO M. CHAVES**  
**June 2, 2006**

The pre-filed testimony of Staff witness Pedro M. Chaves addresses the following issues:

Capital Structure – Staff recommends that the Arizona Corporation Commission (“Commission”) adopt a capital structure for Black Mountain Sewer Corporation (“Applicant”) for this proceeding consisting of 0.0 percent debt and 100.0 percent equity.

Cost of Equity – Staff’s estimated return on equity (“ROE”) for the Applicant is based on cost of equity estimates for the sample companies of 9.6 percent for the capital asset pricing model (“CAPM”) and 9.6 percent for the discounted cash flow method (“DCF”). Staff’s ROE recommendation does not reflect a financial risk adjustment due to the lower financial risk reflected in the Applicant’s capital structure in relation to that of the sample companies because the Applicant’s capital structure is reasonable and the Applicant should be encouraged, not discouraged, to maintain a healthy capital structure. If Staff had made an adjustment for financial risk, it would have been a 0.5 percent downward adjustment (which would result in a 9.1 overall rate of return recommendation).

Overall Rate of Return – Staff recommends that the Commission adopt an overall rate of return (“ROR”) of 9.6 percent.

Staff’s assessment of Applicant’s cost of capital analysis – Staff recommends that the Commission reject the Applicant’s proposed 11.0 percent ROE for the following reasons:

1. The Applicant’s DCF estimates rely exclusively on analyst’s forecasts. In addition, dividend growth is absent from the DCF constant growth analysis.
2. The Applicant’s risk premium analysis is not market based and inappropriately relies on forecasted interest rates.
3. The Applicant is unable to demonstrate how claimed additional risks are not captured by market models.

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DOCKET NO. SW-02361A-05-0657  
STAFF WITNESS – MARLIN SCOTT, JR.  
June 2, 2006**

**CONCLUSIONS**

- A. The Black Mountain Sewer Corporation ("Corporation") wastewater system's total available capacity of 1.12 million GPD is adequate to serve the present customer base and reasonable growth.
- B. The Arizona Department of Environmental Quality ("ADEQ") reported the Corporation's System, Inventory #100351, had no deficiencies and is in total compliance.
- C. The Corporation had an outstanding Arizona Corporation Commission compliance item for a required permit, license or franchise from the appropriate governmental authority as ordered in Decision No. 64748. However, on April 3, 2006, the required documentation was filed. Based on the Corporation's filing of the Operating Agreement with the Town of Carefree, Staff withdraws its recommendation of delaying the effective date of any permanent rates and charges in this proceeding as a result of meeting Commission compliance with Decision No. 64748.
- D. With the filing of the Operating Agreement, the Corporation has no other outstanding Commission compliance issues pending at this time.

**RECOMMENDATION**

- 1. Staff recommends that the Corporation use Staff's wastewater depreciation rates by individual National Association of Regulatory Utility Commissioners category on a going-forward basis.